

CORPORATE INSURANCE LAW

Expert Analysis

Global M&A Insurance: Considerations for Cross-Border Transactions

The use of Representations and Warranties Insurance (RWI) to help facilitate a merger or acquisition has steadily increased to the point that it is now common and parties utilize RWI to address the risks associated with a breach of the seller's representations and warranties in a significant portion of transactions. What was once an unfamiliar niche insurance product has now become a primary tool for mitigating risk and liability for buyers and sellers.

As RWI has become more of an industry norm in the United States, parties have increasingly sought to utilize U.S.-style RWI policies for cross-border transactions (in particular, transactions with non-U.S. parties or non-U.S. governing laws). There are, however, a number of differences between U.S. and international RWI coverage that all parties involved in a deal need to be mindful of from the start to help ensure a smooth transaction.

We have collaborated with our colleagues at American International



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Group, Inc. (AIG) on this column to share some of the central considerations with respect to cross-border transactions, including transactional processes and expectations, local laws and regulations and an insurer's multinational capabilities. Since the late 1990s, AIG insurance companies have issued RWI policies in connection with over four thousand transactions worth more than \$1 trillion in deal value globally. During that same period, AIG insurance companies have seen rapid growth with respect to RWI policies issued in relation to cross-border transactions.

Transaction Process and Expectations

As U.S.-style RWI has become more widely and commonly utilized, there may be a tendency for parties involved in a transaction to either assume that certain RWI-related items will be consistent in cross-border transactions or overlook certain

legal formalities that are required given the cross-border nature of the underlying transaction. When considering the purchase of RWI, it is important for parties to first confer with an experienced insurance broker who can help navigate the process and emphasize the selection of an insurer with the appropriate cross-border capabilities, so that the parties' expectations can be met with respect to these issues.

For example, transaction parties may not be familiar with the level of disclosure that is expected in foreign jurisdictions, which will have an impact both on the transaction and the RWI policy process. Many non-U.S. sellers are unaccustomed to the detailed disclosure requirements and schedules that are typically found in U.S.-style mergers and acquisitions and instead often expect to rely on a more broad-based general disclosure (such as disclosing the entire virtual data room against the representations and warranties as a whole, instead of preparing itemized disclosure schedules). Consequently, a buyer will often, understandably, want to disregard the general disclosure for the purposes of the RWI policy. This will be problematic, however, if the effect of disregarding the

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general disclosure would be to leave the insurer without any disclosures—specific or otherwise—to qualify the representations (a scenario likely to be unacceptable to the insurer). To facilitate the success of a merger and acquisition transaction, it is therefore critical that the transaction parties, the broker and the insurer discuss expectations from the outset and ensure that all parties are on the same page regarding the proposed approach to disclosure.

There may also be differences in policy terms and underwriting processes in cross-border deals. For example, a *de minimis* claims basket, in which claims below a certain amount are disregarded, is often expected in non-U.S. RWI policies, whereas in the United States a *de minimis* claims basket is only expected in certain circumstances. Some non-U.S.-style RWI policies may also have a “tipping retention,” whereby once a retention is met, 100% of covered losses are subject to reimbursement, which is not customary for U.S.-style RWI policies. A non-U.S. underwriting process is also more likely to include written questions and responses prior to an underwriting call, and the underwriter may make more detailed comments on the transaction documents themselves—including significant modifications to be read into the representations for purposes of the policy. In contrast, in U.S.-style underwriting, efforts are typically made to keep transaction document commentary to a minimum to the extent possible. There are usually no written responses to preliminary underwriting questions and only a formal underwriting call during which underwriters speak

directly with the appropriate transaction party and its advisers.

If U.S.-style coverage is desired, it is important for the parties to discuss this expectation at the outset and communicate it to the insurance broker. Clients are best served by engaging local counsel to address specific foreign jurisdiction legal issues as well as custom and practice. By working with experienced advisers and by engaging an insurance underwriting team with global reach that can manage a multinational process efficiently, transaction parties can put themselves in the best position to meet expectations and avoid unnecessary challenges and delays.

Local Legal and Regulatory Considerations

Even where all parties to a cross-border RWI process have experience and an understanding of what to expect, it is still possible for unfamiliar legal and/or regulatory issues and concerns to arise as a result of the cross-border nature of the transaction.

For example, depending on the location of the named insured party, the RWI policy may need to be governed by non-U.S. law. One example of this is China, which requires any RWI policy issued in China to be governed by Chinese law. Transaction parties should consider what impact this may have as it relates to matters such as conflict of laws, since it is possible that various agreements related to the transaction will be subject to different governing laws.

Specific regulatory approvals may also be required in connection with the issuance of RWI or other insurance policies. In China, for example, an RWI policy form must be localized

and filed with the Chinese regulator, and any material amendments to the filed form may require further regulatory filings and cause potential delays.

In some jurisdictions, “umbrella” laws are in place that govern insurance products subject to local law, such as the United Kingdom, which imposes a duty of fair presentation on the insured that requires disclosure to the insurer of material information; whether information is considered material depends on the nature of the risk and the coverage sought, but generally information is material if it would influence the judgment of a prudent insurer when determining the premium to be charged, the terms and conditions of the policy and/or whether to provide insurance coverage at all. The failure of an insured to comply with these disclosure requirements may give the insurer access to a range of remedies, which could potentially result in reduced or even no coverage.

Certain jurisdictions may also impose unfamiliar legal formalities that will need to be addressed in order to minimize last-minute issues or delays as the transaction parties are looking to sign or close complex cross-border deals. For example, in China, a Chinese version of the RWI policy must be prepared, with such Chinese version being the policy of record in connection with any future claims process or regulatory action. Some jurisdictions may also require a formal endorsement process that governs amending RWI policies.

It is also important for parties to consider whether an insurer is authorized to *both* write a RWI policy *and* to pay claims in a particular jurisdiction or whether there are any exchange

control or other restrictions. An insurer authorized in a particular jurisdiction may be prohibited from paying claims into another jurisdiction, where the insured wishes the payment to be made. If this issue is not addressed properly at the outset, it could lead to potential tax or other logistical issues. Different jurisdictions may also levy different Insurance Premium Taxes (IPT), which could have a material economic impact on the insured.

RWI Market Snapshot

The growth of cross-border transactions utilizing RWI is consistent with historical market trends more generally, which, subject to significant and unique market disruptions, has seen increased transaction volume and increased claims volume over time.

As documented in the 2019 M&A Insurance Claims Report, *Taxing Times for M&A Insurance* (the Claims Report), prepared by the AIG insurance companies, 20% of RWI policies written globally from 2011 to 2017 resulted in a claim notification. In the United States specifically, that figure is 24%. Larger and more complex deals have proven to be even more likely to lead to a claim and a larger loss.

During the Claims Report period, the most common categories of claims involved breaches of representations and warranties related to Financial Statements (19% of all claims globally), Taxes (18% of all claims globally) and Compliance with Laws (15% of all claims globally). Claims severity has also shown a trend of steadily increasing over time. Globally, the proportion of claims over \$10 million has nearly

doubled year over year during the Claims Report period, from 8% to 15% of overall claims activity.

As transaction volume has increased over time, increased competition among insurers has driven premium rates downward. While this paradigm was initially welcomed by buyers, various insurance carriers have indicated that increased claim volume, rising loss costs, persistent low interest rates and other factors are driving the need for RWI carriers to increase premiums and align insurance rates with the risk scope trajectory to keep pace with loss trends.

The current RWI market appears to bear some similarity to the D&O insurance market, which is in the midst of a multi-year cycle that began for certain segments in 2016. In general, strengthening pricing and responsibly managing limits, among other underwriting actions, will help insurance carriers avoid broad affordability and availability issues in the long run.

As transaction and claims volume increase, it is important for buyers and sellers to partner with insurance carriers who have the unique market reach to facilitate complex transactions; the data-driven insights to anticipate and proactively address issues; and the claims capabilities and financial strength to handle potential claims well after the deal closes.

Looking Forward

RWI has definitely grown over time from a bespoke insurance solution into a key component of many domestic and cross-border mergers and acquisitions. As coverage, laws and regulations continue to vary across jurisdictions and claims frequency

and severity increase, it is important for buyers and sellers to work closely with their insurance broker and insurance carrier to navigate the complexities of cross-border transactions and the overall risk landscape. The COVID-19 outbreak has created, at least in the short term, more uncertainty with respect to cross-border transactions. While all parties are still working through these new challenges, creative solutions are more likely if insureds, brokers and insurers work in partnership.

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